



CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

November 18, 2004

Robbie Rudolph, Secretary  
Finance and Administration Cabinet  
Capitol Annex, Room 383  
Frankfort, KY 40601

Dear Secretary Rudolph:

During this year my office has responded to specific requests to review state agency financial procedures after problems have been identified handling cash and other negotiable instruments. I want to commend the Secretary of State, Kentucky Correctional Industries, and the Kentucky Education Professional Standards Board for taking an aggressive, proactive position in addressing the problems in their agencies.

These reviews have highlighted the need for all state agencies that handle cash and other negotiable instruments to review their current procedures and, where necessary, implement or revise their procedures to improve accountability and oversight.

Attached are recommendations to improve accountability and oversight of cash management policies that should be considered and suggested to state agencies or implemented by the Finance and Administration Cabinet. The Finance and Administration Cabinet, given the statutory role in agency financial operations, is the most appropriate agency to recommend agency action in this matter.

My office is available to assist your agency or any state agency in strengthening current procedures.

Thank you for your assistance and cooperation, and I look forward to working with you on this and other issues.

Sincerely,

A handwritten signature in cursive script, appearing to read "Crit Luallen".

Crit Luallen  
Auditor of Public Accounts

Attachment





**COMMONWEALTH OF KENTUCY**  
**Auditor of Public Accounts**  
**Cash Management Recommended Practices**  
**November 18, 2004**

As part of our review of cash and receipt handling procedures in several areas throughout state government, we have observed several instances of individuals with incompatible duties, and other control weaknesses in the handling and security of liquid assets.

There are employees who perform more than one of these duties: opening mail, handling service requests, making refunds, making deposits, making adjustments to the accounting records, posting to the accounting records, and conducting reconciliations between cash receipts and the accounting data. The more of these duties performed by one person, the greater likelihood of error or loss of assets. However, we recognize that limited resources may prevent an agency from assigning each function to a separate employee. In the absence of properly segregated duties, agencies should seek ways to provide compensating controls over these functions that will limit the risk exposure associated with cash and receipts.

In addition, we have noted that cash and other negotiable instruments are not adequately recorded upon receipt and are not always secured when staff persons are away from their workstation or area. In some cases accessibility to the cash and other negotiable instruments is not limited to those with a need to have access. Our comments and recommendations relating to our review follows.

**1. Segregation Of Duties**

The objective of segregation of duties is to ensure that assigned duties are separated such that no one employee or group of employees should be in a position both to commit and/or conceal errors or irregularities in the normal course of performing their assigned duties. In general, the principal incompatible duties to be segregated are:

- Authorization of transactions;
- Custody of assets;
- Recording or reporting of transactions.

In addition, the same individual responsible for recording or reporting the transaction should not perform a control over the processing of a transaction generally.

Adequate segregation of duties reduces the likelihood that errors, either intentional or unintentional, will remain undetected. This is carried out by providing for separate processing by different individuals at various stages of a transaction and for independent reviews of the work performed.

Adequate segregation of duties assures the following activities:

- Fundamental controls over cash and receipt activity are in place
- Appropriate authority levels are in place
- Reconciliation of financial information is being performed
- Independent supervisory review of the reconciliation process
- Adequate monitoring of operations and financial performance

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**November 18, 2004**

**1. Segregation Of Duties** (Continued)

**Recommendation**

FAC should promulgate policies and procedures to ensure that agencies adequately separate job duties to ensure that the risk of errors, either intentional or otherwise, is substantially reduced. Furthermore, FAC should conduct random reviews in areas with substantial cash handling.

**2. Receipt Of Cash Should Be Properly Recorded In The Accounting Records**

A major control procedure for ensuring cash collections are recorded in the accounting records is documenting cash collections at the time of receipt. Pre-numbered remittance advices and cash receipt listings are frequently used to document cash received through the mail. Copies of these documents can be used later to make independent comparisons of the cash collections recorded and deposited in the agency's account. The duties of receiving cash and preparing the initial documentation should be segregated from the duties of making entries in the accounting system, posting the cash collections, and depositing them. In addition, checks should be restrictively endorsed "for deposit only" immediately upon receipt.

**Recommendation**

We recommend that FAC recommend to agencies handling daily cash receipts through the mail and in person, document receipt of the cash at the initial receiving point. These receipt listings can later be used as a reconciling mechanism to determine that all monies received have been properly deposited and accounted for.

**3. Negotiable Instruments Should Be Restrictively Endorsed Upon Receipt**

During our review we noted that several agencies do not restrictively endorse checks or other negotiable instruments upon receipt. A restrictive endorsement on checks or other negotiable instruments deters the potential for theft or other loss. Even though Treasury does not require state agencies to restrictively endorse checks or other negotiable instruments at the agency level, Treasury encourages agencies to restrictively endorse checks received before forwarding the checks or negotiable instruments to Treasury for deposit.

**Recommendation**

We recommend that agencies restrictively endorse checks immediately upon receipt. The individual assigned to open incoming mail should make the endorsement.

**4. Security Over Receipts Should Be Improved**

In several instances during our reviews, we noted that security over cash and receipts was lax. Cash and receipts were often left unattended, or stored in areas that were accessible to several people, or not locked in a secure location. In addition, mail containing cash and checks were also left unattended, or improperly stored. Physical security over all assets, especially liquid assets should be improved.

**COMMONWEALTH OF KENTUCY**  
**Auditor of Public Accounts**  
**Cash Management Recommended Practices**  
**November 18, 2004**

**4. Security Over Receipts Should Be Improved** (Continued)

Associated with the security over cash and receipts is the accessibility to secured storage locations by employees or other persons. In some cases during our review, we noted that safes, or lockable desks and filing cabinets were easily accessible to several staff persons. When personnel are given access privileges beyond those necessary to perform their assigned duties, a breakdown in internal controls can occur.

**Recommendation**

FAC should recommend that physical security over receipts, including the mail and related receipts, be emphasized by state agencies and improved where applicable. Cash, checks, and mail containing related receipts should not be left unattended during the day (these items should be locked anytime the clerk leaves). Further, sufficient security devices, either a safe or lockable desk or filing cabinet, should be used for unprocessed mail or unprocessed business activity and related receipts when staff leave for the workday.

Further, access to the safes or other security devices should be restricted to personnel whose job duties would require such access.

**5. Financial Reporting Should Be Used To Assist In Monitoring Financial Activities**

Our reviews noted that agencies do not always make sufficient use of financial reports to monitor financial activities. We noted that there is no overall daily receipt report that clearly summarizes the collections by all clerks and reconciles them with the deposits. One person is assigned to collect the daily closeout bundles and there are not any reports reconciling how much he/she collected or how much he/she submitted to the person who prepares the deposit. There are not any reports reconciling the daily closeout sheets to how much is deposited into Treasury. There are not any reports reconciling how much money comes in from all sources to how much money gets deposited and posted to the accounting system.

Further, there were no monthly reports summarizing and reconciling all receipts recorded by the clerks to the monies actually deposited into Treasury.

**Recommendation**

We recommend FAC assist agencies in creating receipts reports to be used as a tool for management. These reports can be used to monitor activities and perform various reconciliations. Performing reconciliations and independent supervisory reviews are key components of good internal control over a cash receipts process. The agencies should conduct some or all of the following periodic reconciliations:

1. Someone independent of the cash receipt function should summarize cash receipts and this cash summary should be compared to the Treasury deposits to ensure that all collections are deposited intact. Another approach to this reconciliation would be reconciling the deposits of receipts into MARS to the agency's internal accounting system.

**COMMONWEALTH OF KENTUCY**  
**Auditor of Public Accounts**  
**Cash Management Recommended Practices**  
**November 18, 2004**

**5. Financial Reporting Should Be Used To Assist In Monitoring Financial Activities**

(Continued)

**Recommendation**

2. Someone independent of the cash receipt function should reconcile the mail log, where cash and receipts are initially received, to the daily cash and receipts activity.
3. Someone should subsequently compare the actual currency and coins deposited with the actual currency and coins received.
4. The money received on prepaid accounts should be reconciled with deposits and postings to the accounting records.
5. The total credit card payments recorded in the internal accounting system should be reconciled with the total credit card payments shown as being deposited into Treasury and posted to MARS.

**6. Timely Deposits Need To Be Made**

In some cases, we noted that receipts were not deposited for several days or weeks. While in some cases the amounts were not significant, it nonetheless increases the risk of loss or theft. Failure to make timely deposits increases the risk of loss due to theft or human error. In addition, the state loses money in interest income on monies that could have been invested; and, at year-end it creates problems with financial reporting and revenue recognition.

**Recommendation**

FAC should create a policy requiring all monies be deposited into the state Treasury when received or within three business days.

**7. Written Policies And Procedures Should Be Prepared**

In most cases, our review noted that there are no formal written policies and procedures covering the operations of the entity's business activities. We believe that written policies and procedures provide for consistent preparation of work product, ensure that staff is aware of management's expectations, provide staff with guidance when questions may arise, assist in training new employees, and reduce the risk of misunderstanding in oral explanations.

**Recommendation**

We recommend that FAC ensure all agencies create and maintain written procedures for the entire organization's business activities, including the handling of cash receipts. Periodically, management should conduct reviews to ensure personnel are adhering to written procedures.